BDS Guidelines Workshop:

sustainability methods used by international BDS organizations

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Overview

- One month assignment – complete NFS pricing system
- Really… about sustainability – pricing one key part
- To set up sustainable pricing system (now collecting):
  - Services in-demand by NFS clients (MSMEs)
  - Services viewed as quality by NFS clients
  - Which ones clients will pay for
  - Cost data to provide NFS services
  - Useful… competitors prices for similar services
- Today objective: show BDS sustainability methods by other orgs (including costing & pricing)
- 45 slides - for background, but more than can cover

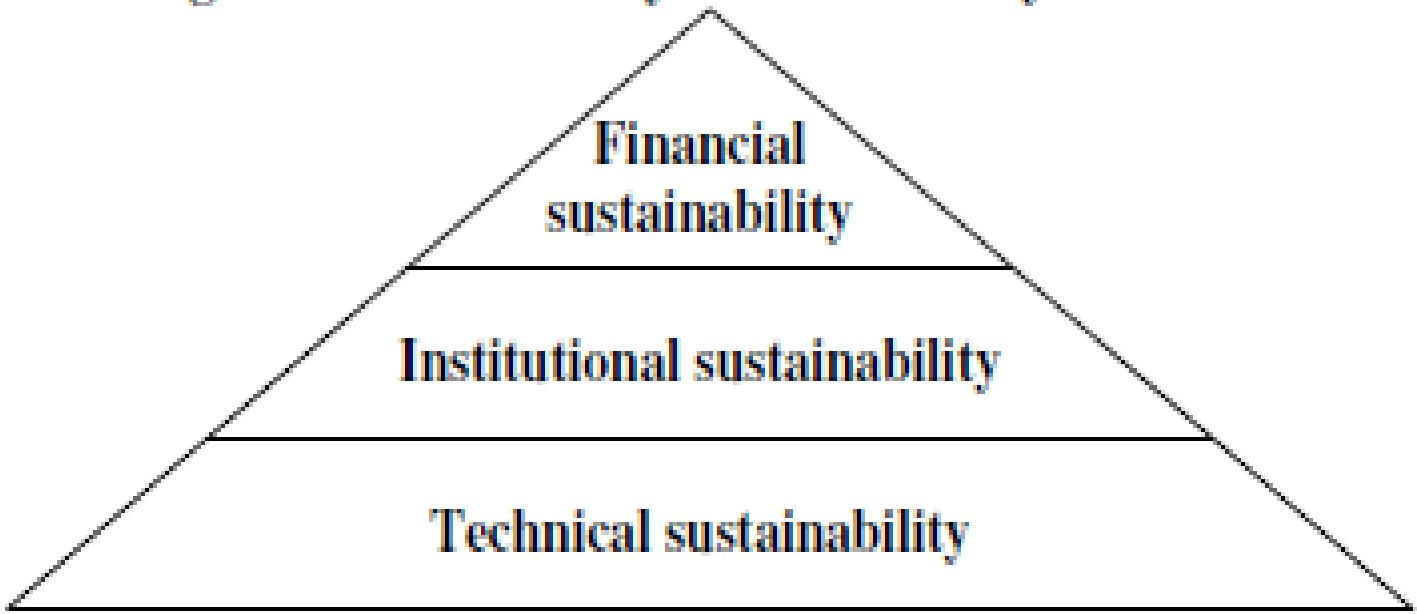
Main topics – for benchmarking against other BDS organizations

- Strategies to achieve **sustainability**
- Ways to assess **service demand**
- Common **pricing methods**

Sustainability

BDS Organizational Sustainability

Figure 5 The hierarchy of sustainability dimensions



Technical sustainability – meeting the needs of the target group
Institutional sustainability – reaching the target in a cost efficient way
Financial sustainability – receiving participant fees for cost recovery

Commercially Sustainable BDS, ILO

Technical Sustainability Requirements

Meeting the needs of the target group involves:

- Offer access to qualified, experienced providers
- Ability to adapt to target group – communication
- Promote services by educating target groups
- Make services tangible (certifications)
- Be efficient in delivery (shorter, not expensive)
- Follow-up dramatically improves tangible results

Institutional Sustainability Requirements

Reaching the target group in a cost efficient way

- Capacity to deliver services – facilitation & direct
- Close in culture to MSMEs – culture & geography
- Low cost structure
- Commercial focus – not bureaucratic & s.ow
- Organizationa. stabi.ity - consistent po.icies

Top of the pyramid: Financial Sustainability Requirements

Receiving participant fees for cost recovery

In difficult economies, successful BDS offer:

- Low cost services with rapid client impact
  - Reduce costs by facilitating small BDS providers
  - Modular services to be sold in smaller pieces
  - Low-cost introductory services with immediate value to draw in new clients (access to a new retailer)
  - Group purchase discounts & assist to find participants
  - Installment payments for some services (risky)
  - Payment based on success fees (hard to calculate)

Top of the pyramid **(cont'd)**

Financial sustainability tools

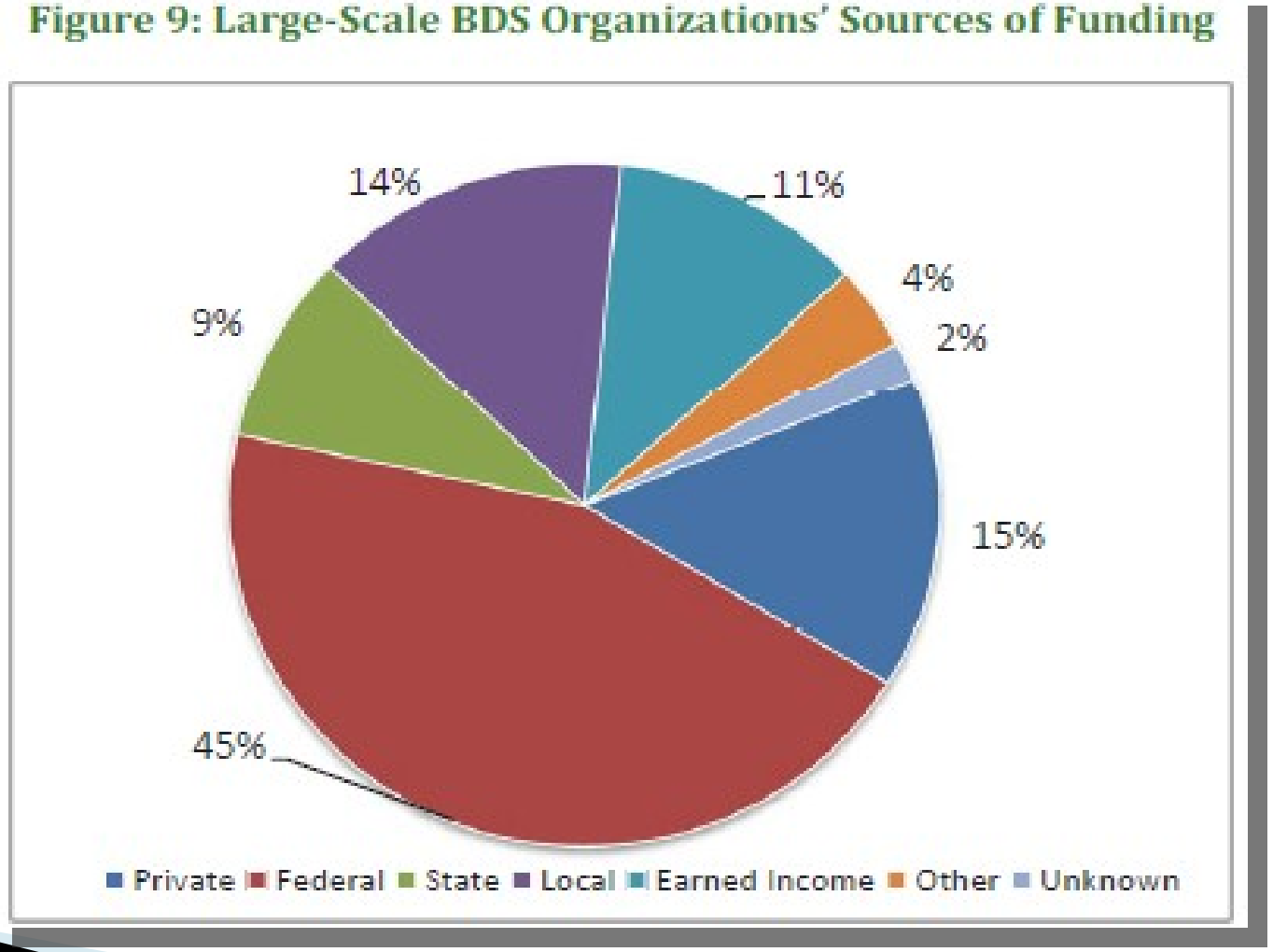
- **Embedded payments** – most BDS orgs who offer both lending and NFS embed fees in loan repayments:
  - NFS + Lending = much stronger combination than one or other
- **Cross-selling** – lending staff promote NFS when meeting clients, all tech dept's should sell each other
- **Cross-subsidizing** – better fee generating services help pay for others that can only have a low price
- **Third-party payments** – from corporations (CSR)

Assessing financial sustainability of indiv. services in BDS organizations

- **AWARENESS RATIO**: % of MSMEs aware of a specific service – **if low then outreach is probably weak**
- **REACH RATIO**: % of MSMEs who are aware of and try a service – **if low then the services being offered are probably not in demand**
- **RETENTION RATIO**: % of MSMEs who try the service and use it multiple times – **if low then the service quality may be weak or not giving tangible results**

For sustainability a BDS organization needs a strong retention ratio for services – tried and reused.

How sustainable are large, non-profit BDS organizations?

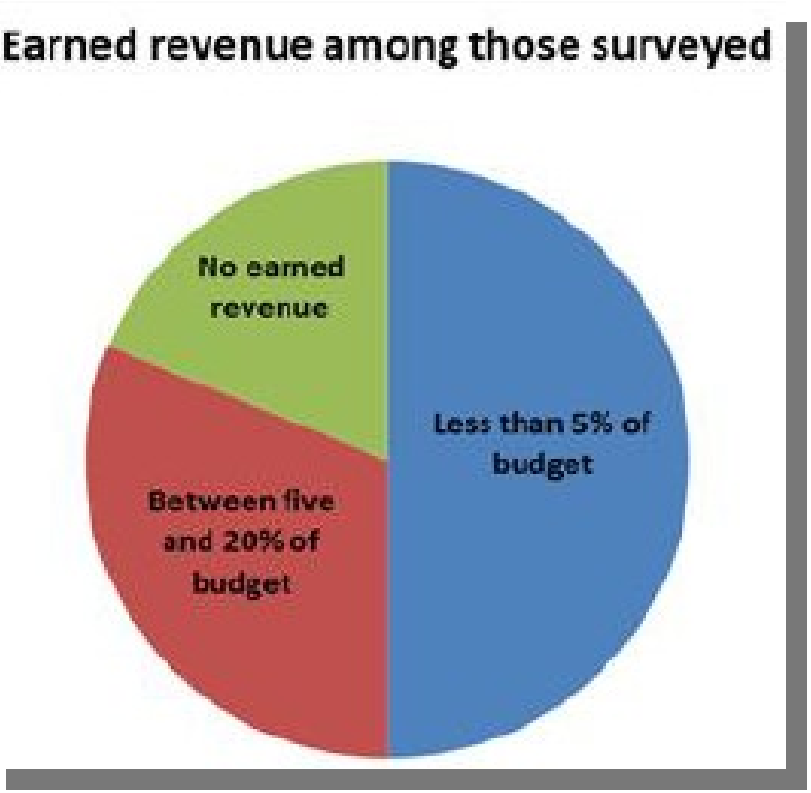


The State of Business Dev. Services, The Aspen Institute

How sustainable are non-profit BDS organizations? (cont'd)

Table 5: Operating Budgets and Cost Recovery

FY08	Operating Budget	Cost Recovery
ACEnet	$699,400	62%
MercyCorps Northwest	$700,403	11%
MicroMentor	$250,184	0%
Mountain BizWorks	$1,666,449	17%
Renaissance Entrepreneurship Center	$2,900,000	15%
WESST	$2,060,174	6%
Median	*$1,183,426*	*13%*
Mean	*$1,379,435*	*17%*



Most BDS recover about 15% of their costs from service fees

Focused on Growth: Scaling BDS, The Aspen Institute

Sustaining Business Dev. Services, The Aspen Institute

This means fundraising will remain a critical part of SFD sustainability

What stands out in the CEO interviews is the marketing and communications capacity noted to run a solid development effort. That includes good brand development supported by materials with a professional, clear and inspiring message, and maintaining the brand and message consistently across communications channels (web, social media, print, events).

Sustaining Business Dev. Services, The Aspen Institute

“Although earned revenue is not the largest revenue stream for most organizations, practitioners consider it a necessary component of their sustainability strategy for several reasons. Clearly, it covers part of an organization’s costs. Earned revenue also provides greater flexibility for managers, demonstrates an entrepreneurial orientation to funders, and is an important way of ensuring that clients have “skin in the game,” thereby ensuring that program services are being delivered to those with the greatest commitment. “

Sustaining Business Dev. Services, The Aspen Institute

BDS revenue generating examples

Box 1: Approaches to Earned Revenue

- **ACEnet**: With a specialization in food enterprises, ACEnet charges client fees for in-person and distance training. ACEnet also generates contract revenue for consulting services associated with its multiple brand strategies and experience in operating a kitchen incubator.
- **The Entrepreneur Fund**: In 1998, the Entrepreneur Fund developed the CORE FOUR business-planning course. The Fund trains and certifies other organizations to use the course, which has been adapted widely in the industry. It has also found additional markets for the curriculum in community colleges, technical colleges, chambers of commerce and others.
- **Wisconsin Women's Business Initiative Corporation**: Among varied approaches to earned revenue, developed a social enterprise, Coffee with a Conscience™. The café generates a net profit, all of which is used to cover WWBIC's operational expenses.
- **WESST**: In 2009, it opened a mixed-use business incubation facility in Albuquerque, which has become a hub for its services. Most recently, it added a digital media studio in the facility. In addition to supporting the creation of distance learning content for WESST clients, the organization expects to generate revenue by leasing the studio to advertising and marketing firms, game and application developers, and independent filmmakers.

Sustaining Business Dev. Services, The Aspen Institute

Assessing demand for services

Assessing demand is part of a larger process

The World Bank lists three primary types of research carried out by successful BDS providers

Client impact – improvements in MSME performance or broader social and economic impact (employment)

Institutional development – BDS organization outreach, cost effectiveness and sustainability

Market impact – MSME awareness, trial and repeat usage of services, satisfaction with them

It is this last one - *market impact* – that best addresses how to gage demand for BDS

BDS for SEs Guiding Principles report, World Bank CDASED

Biggest assessment challenge: will MSMEs pay for services?

Test marketing a new fee-based service usually best way to answer the above question

- Quickly reveals **buyer profiles** most likely to pay
  - Industry sectors, gender, regions
- Provides immediate feedback about the service
- Allows testing of different services alternatives
  - bundled with other products, service duration
- Test market results – higher in validity, surveys are more prone to error

But test marketing is costly & time consuming – surveys popular with BDS

Standard research surveys can – though not always – predict demand for a service by revealing:

- % of MSMEs who **say they will pay** for a service
- % of MSMEs who **say how much they will pay** for a service
- % of non-users who **say a service is important**
- % of non-users whose **reason for not buying** can be addressed by the BDS facilitator/provider

A range of survey tools exist to help determine demand

- Usage, attitude, image (UAI) study
- Focus group discussion
- In-depth one-on-one interview
- **Product concept test**
- **Price sensitivity test**
- Customer satisfaction survey
- Written questionnaire
- Telephone survey

Applying Market Research Tools to the Design and Improvement of BDS, Microenterprise Best Practices, DAI

Product concept & price sensitivity test

- **Product concept test** – to determine if a service's intended features satisfy target MSME needs
- **Price sensitivity test** – to determine which price target MSMEs may pay and if different customer profiles will pay different amounts

These are often used together by BDS orgs to assess demand for services at various prices

Product concept & price sensitivity test (cont'd)

The flow of the questionnaire is as follows:

1. Exposure of respondent to service concept
2. Respondent's thoughts about service concept
3. Rating service concept on specific features
4. Overall rating of service in terms of importance
5. Interest in purchasing the service
6. **Price sensitivity test – a series of prices and identifying the price range willing to pay**
7. Other similar services and how they compare to the one being discussed

Product concept & price sensitivity test (cont'd)

Information obtained

- **Qualitative info** opinions positive and negative
- **Quantifiable ratings** on service features
- **MSME interest** in buying the service
- **Service price ranges**
- **Real competitors** for the service identified
- **What MSMEs do now** to achieve similar benefits
- **Potential market size** for the service
- **The price to maximize revenue** and which MSME profiles will pay what amounts

Applying Market Research Tools to the Design and Improvement of BDS, Microenterprise Best Practices, DAI

Effective surveying methods checklist

- **Pre-test** all surveys with a small number of respondents
- **Ask for personal data at the end** of the questionnaire to avoid suspicion and help cooperation
- **Include interviewer directions** in the questionnaire (if no, skip to Q8)
- **Use a multiple choice *show card*** to help respondents select answers about personal information (incomes)
- **Keep questionnaires short** as possible to avoid frustration, rushing and inaccuracy
- **Use a random sample** when possible or
- **Use a stratified sample** if multiple MSME profiles are important
- **30 respondents** is believed to be the minimum number of responses for statistically significant results

Common pricing methods

Cost and price versus value

It is important to know the difference between:

- **Cost** - the amount to produce the service
- **Profit** – the financial reward for providing it
- **Value** – what customers think it is worth

BDS orgs should be concerned with:

- **Cost** - the amount to produce the service
- **Cost recovery – some level of revenue though not necessarily above <u>total costs</u>**
- **Value – what customers think it is worth**

So what are total costs?

- **Overhead (indirect) costs**
  - Office & facility expenses (supplies, rent, electricity)
  - Business expenses (advertising, vehicles, accountants)
  - Indirect labor (office staff, Finance, IT, management)
- **Direct labor costs**
  - Any employee who provides client services
  - Cost = number of days X employee daily rate
- **Other direct costs (specific to client assignments)**
  - Any costs resulting from delivering services to clients
  - Cost = transportation, printing, outsourced trainers
- **Total Costs = The sum of all three costs**

How is overhead calculated? One simple method for organizations charging fees to clients:

Total organizational overhead costs for one year:

1,500,000 LE

Total salaries of employees who charge their time to clients (direct labor):

2,500,000 LE

BDS organizational overhead rate =
total overhead / total direct labor
1,500,000 LE / 2,500,000 LE
= 60% of direct labor cost

How is overhead calculated (cont'd)
Another simple calculation (there are many)

Total organization overhead (indirect) yearly costs:

1,500,000 LE

Total square meters of organization offices:

10,000 meters

Dep't Z office space square meters:

2,000 sq meters (= 20% of total)

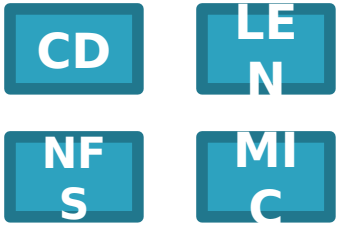
Dep't Z apportioned overhead: **20%**

Dep't Z overhead: 1,500,000 x 20% = 300,000 LE annual overhead cost (or 25,000 LE per month)

How SFD Finance calculates overhead (indirect costs) for NFS:

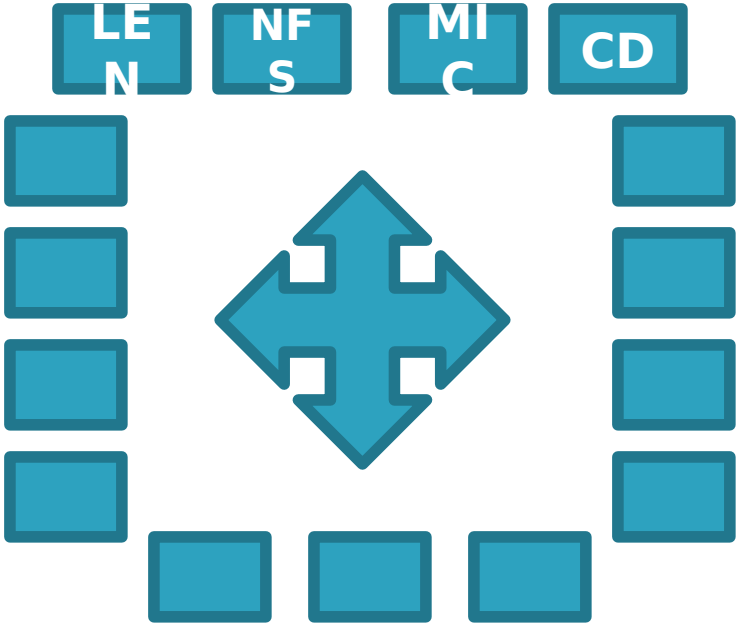
Technical Sectors

Sectors



1) Direct costs Technical sectors considered cost centers: direct costs tracked (salaries, event expenses) then indirect costs estimated (electricity, phones) combined into *direct costs* for each technical sector

All SFD Support & Technical



2) Indirect costs: Each sector estimates the effort to support every other sector then arrive at a % of SFD indirect costs (common costs) assigned to each sector

One more overhead concept BDS orgs use: Variable overhead

In some cases BDS organizations may have certain kinds of unpredictable costs, which creates more risk when pricing services

Example: Outsourced BDS providers might often back out at the last minute before training event (after people have paid) – requiring a more expensive person be hired

In this case, BDS orgs use variable overhead to reduce this risk:

- 5% on all direct costs to hold the event except for
- 10% on outsourced BDS providers

Common ways to price services

1. Based on being lower or higher than competitors' prices

2. Based on covering costs to offer the service

3. **Based on perceived value to the customer while being aware of the costs**

Being aware of the price/cost relationship:

1. **Zero fees to users [social good]**
2. **Subsidized price [social price]**
3. **Equal to direct cost [dir. cost coverage price]**
4. **% above direct cost**
5. **[indir. cost contr. price]**
6. **% above direct & indirect cost [profit**

NFS NOW	NFS NEAR FUTURE
> 90%	25%
< 10%	70%
0%	5%
0%	0%
0%	0%

Simple cost coverage (on direct costs) example

NFS Industrial Dep't arranges a B2B event for 1 day and gets 20 furniture makers to agree to attend; direct costs will be 2,000 LE , so furniture makers are charged 100 LE to exhibit

Total revenue = 2,000 LE

Event budget for direct costs (other direct costs)

- **Venue costs paid by NFS 1,000 LE**
- **Printing paid by NFS 200 LE**
- **Advertising paid by NFS 500 LE**
- **Transport for NFS staff 300 LE Subtotal other direct costs 2,000 LE**

Direct cost coverage 100%

Simple indirect cost contribution (over direct costs) example

Same B2B furniture example but NFS charges 120 LE (instead of 100 LE) to 20 furniture makers

Total revenue = 2,400 LE

Direct costs (other direct costs)

- **Venue 1,000 LE**
- **Printing 200 LE**
- **Advertising 500 LE**
- **Transport 300 LE Subtotal other direct costs 2,000 LE**

Contribution margin 400 LE

Contribution to indirect cost 20%

Example of profit (over total costs)

NFS Entrepreneurship conducts entrepreneurship training for 2 days for 30 people and charges 100 LE/person

Total revenue = 3,000 LE

Dir. labor (NFS trainer) 2 days x 425 LE daily rate = 850 LE
Indirect costs @ 60% of direct labor = 586 LE
Other direct costs (venue, printing, coffee) = 1,400 LE
Subtotal all direct & indirect costs 2,836 LE

Profit above total direct & indirect costs 167 LE
Profit 5.9%

Ways BDS orgs charge MSME clients

- **Hourly rate** – less risk for service provider but requires trust on the part of MSME
- **Flat fee** – viewed by MSME as lower risk to them; it is also the usual method for training
- **Variable pricing** – charging different rates to different types of clients, example for exhibitions department:
  - Companies with 1-5 employees pay 200 LE
  - Companies with 6-10 employees pay 300 LE
  - Companies with 11 and more employees pay 500 LE

VARIABLE PRICING IS AN ESSENTIAL TOOL USED BY BDS ORGANIZATIONS TO MORE AGGRESSIVELY CHARGE FEES

- It is the best way to allow social good to continue for micro companies while ensuring those companies who can pay do so

EBRD advisory services program pricing

Pricing and charging methodology

- MSMEs will pay if they believe ROI will occur
- Price depends on client ability to pay (variable)
- Regions pay less than urban centers
- Should be “a little painful” for client
- MSMEs pay 100% in advance then reimbursed
- MSMEs usually pay between 20%-30%
- If cost is very high – installment payments
- EBRD will not pay directly to a consultant

CROSS-SUBSIDIZING IS ANOTHER IMPORTANT TOOL FOR BDS ORGANIZATIONS

- This allows services that can more easily generate fees to help cover the cost of those that cannot
- Example: To reach their cost recovery goals - the NFS Agribusiness Dep't cannot charge high fees for feasibility studies to micro companies (maybe 30 LE) but they might charge higher fees to cooperatives for capacity building (maybe 250 LE)

A few International BDS pricing examples in price sensitive markets

- $25 **annual fee** for training graduates to access other materials and resources
- $50 **access fee** covering program registration and 6 one-on-one **hours of consulting**
- $25 - $50 **membership** (individual or company) then **$10/hour for consultations** / quarterly meetings
- $60 - $120 annual memberships (depending on company size) with regular monthly group services offered
- One-on-one assistance offered to **registered members (receive consulting at $5/hr)** plus nominal fees for group based training or facilities use

Other pricing considerations

BDS organizations that routinely work in price sensitive markets typically factor in:

1. **Economic conditions and ability of target clients to pay – most crucial for NFS**
2. Competitors prices
3. Statutory/legal ceilings (as with OSS)
4. Political and social pressures
5. Expected inflation
6. Organizational goals for cost recovery

The point is… regardless which cost and pricing methods are used

They need to be:

- **Fairly applied internally** (fair indirect cost apportionment to all sectors and departments)
- **Fairly applied externally** to client MSMEs (variable pricing by size & ability to pay)
- **And realistically applied: achieving full cost coverage for a BDS org is not usually a realistic goal …charging fees for services is realistic**

Sneak preview: some recommendations for NFSCS

- **Shift in organizational culture**
  - Free services are not the norm any longer
  - New focus on services with commercial value – fee generating
  - Donors need to start covering some operating costs
  - Regional office ***theft*** of NFS staff must stop!
  - Indirect cost allocation s/b clearer – NFS unfairly burdened?
- **Service integration** – each SFD client should be offered a menu of integrated NFS services
- **Cross selling** – every tech sector: *sell* services for each of the other sectors, especially Lending & NFS
- **Commercial orientation** – for all of SFD, only possible with fewer, better services (& providers)
- **Shift in public relations** – social service does not mean free, it means low-cost, high value

Sneak preview: (cont'd) some recommendations for NFSCS

- **Client follow-up** – every client needs a single NFS person to coordinate services (relationship manager)
- **Service focus** – cannot do all things well, focus on 2-4 services in each dep't; drop any not in-demand
- **Pricing focus** – should be market-based, not cost-based, though costs must be known and considered
- **Cost/benefit** – other than pilots, NFS needs broad impact; narrowly focused programs are not aligned
- **Reliance on client data** – SFD has admin capacity to better collect and analyze client data to improve svcs
- **Scoping new svcs** – commercial focus & better image means periodically launching new, in-demand svcs